

**SALES AND USE TAX REVIEW COMMISSION
RECOMMENDATION PURSUANT TO P.L. 1999, C. 416**

BILL NUMBER:

S-2312

DATE OF INTRODUCTION:

February 3, 2005

SPONSOR:

Senator Scutari

DATE OF RECOMMENDATION:

April 8, 2005

IDENTICAL BILL:

COMMITTEE:

Senate Economic Growth Committee

DESCRIPTION:

This bill authorizes the designation of a joint urban enterprise zone by the Urban Enterprise Zone Authority.

ANALYSIS:

This bill is proposed to amend the Urban Enterprise Zones Act, N.J.S.A. 52:27H-60, et. seq., to allow the designation of a joint urban enterprise zone by the Urban Enterprise Zone Authority.

The Urban Enterprise Zone Program has expanded in ways that the original drafters never intended. For instance, prior to 1994, ten towns in eleven municipalities were designated as Urban Enterprise Zones; however, in 1994, legislation authorized the creation of ten additional zones and in 1995, legislation added seven more zones. In 2002, legislation added three more zones to that list. Finally, the thirty-second zone was added in 2004. In addition, Urban Enterprise Zone-impacted business districts, areas that have been “negatively impacted” by the presence of two or more adjacent Urban Enterprise Zones, have been created wherein reduced sales tax is collected. If there was a consensus that the Urban Enterprise Zone Program is operating as intended and is thought to be effective and efficient then the amendments set forth in this bill may represent sound policy. However, there has never been an independent, comprehensive analysis performed that confirms that the Urban Enterprise Zone Program has actually been a benefit to the participating communities, yet the Program is being constantly amended and expanded.

This proposal is flawed for several reasons. The greater the number of municipalities that have 3% sales tax, the more that New Jersey becomes a patchwork of differing sales tax rates. This is contrary to tax simplicity and uniformity. Adding more zones may create a slippery slope because other municipalities which are similarly situated to the joint zone may petition to become another Urban Enterprise Zone. This domino effect defeats the original purpose of the Urban Enterprise Zones Act of helping to revitalize the State’s

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economically distressed urban areas. Given the ease with which the Urban Enterprise Zone Program is being expanded, it is conceivable that all municipalities in New Jersey will be able to credibly and successfully press for Urban Enterprise Zone status. As originally conceived, the Program was to be limited and its benefits restricted to the most dire cases. This bill does not establish that its provisions would further that purpose.

As the number of zones increase, the challenge of enforcement expands. Due to the high number of zones in existence, New Jersey no longer enjoys the administrative simplicity it once did with sales tax uniformity across the State. The Statement attached to this proposed legislation does not explain why the municipalities which will comprise the joint zone would benefit from Urban Enterprise Zone designation. In addition, the bill does not provide an economic study to justify the creation of a joint zone. It does not provide any information that would demonstrate that such designation would reverse the economic decline of the affected municipalities or attract businesses or customers to those municipalities. Conversely, it does not demonstrate that if enacted, it would not draw businesses or customers from other depressed municipalities, or if it would do so, then such an effect is economically justified.

Since the inception of the Urban Enterprise Zones Act, competitors located outside of the zones have complained of and have perceived unfair tax advantages for vendors located within the zones. There have been many complaints of fraud submitted to the Urban Enterprise Zone Authority and to the Division of Taxation by vendors located outside of the zones charging that Urban Enterprise Zone vendors purchase items tax-free and then transport the property to other locations for use outside of the zone. Permitting more vendors the entitlement of a tax exemption would exacerbate the already tenuous foundation upon which the Act is based.

A major reason many municipalities are now petitioning for an Urban Enterprise Zone may be the belief that such a designation would replace revenue that the municipality is currently losing from other sources. For instance, many municipal representatives have testified to the Sales and Use Tax Review Commission that Urban Enterprise Zone designation would benefit the municipality since they are currently experiencing financial problems. The main theme in urging the Commission to approve a bill creating yet another zone, stresses that Urban Enterprise Zone status would provide funds for municipal use.

Since the inception of the Urban Enterprise Zones Act, its Constitutional validity has been brought into question. Under the Commerce Clause, a state may not impose taxes on out of state sale transactions that exceed the taxes imposed on in-state transactions. The Urban Enterprise Zone program halves the 6% sales tax rate for sales that take place within a zone. However, New Jersey law imposes a 6% compensating use tax on goods purchased outside of New Jersey but brought into the State for use here. Thus, the law appears to discriminate between a "sale" and a "use" based upon where the

transaction occurs. As a result, non-Urban Enterprise Zone New Jersey retailers are forced to compete with out of state retailers that deliver goods into a designated zone, as well as with the in-state Urban Enterprise Zone vendors. To comply with the Commerce Clause, the Division must take the position that a New Jersey purchaser would be able to claim a 3% use tax rate if delivery is taken within the zone. The de facto extension of the 3% rate to retailers outside of New Jersey was never contemplated, but is nonetheless a real consequence of this program. Any expansion or creation of new 3% zones only perpetuates this situation.

Finally, expanding the Urban Enterprise Zone Program would further alter the broad-based nature of the sales and use tax. A broad-based tax, imposed with limited exemptions on a wide range of transactions, is easy to understand and administer, and is generally perceived as economically neutral and “fair.” When imposed at a fairly low rate, the burden, per transaction, on the individual taxpayer, is relatively small, but the cumulative revenue generated can be enormous. Expanding the Urban Enterprise Zone Program by adding more 3% zones would save an individual taxpayer and vendor a fairly insignificant sum every year. However, the cumulative loss of revenue to the State is substantial, leaving the State to find other means of generating the money lost as a result of expanding the program. This loss of revenue would be considerable because the 3% sales tax collected by qualified vendors is remitted to the municipality in which the Urban Enterprise Zone is located and not to the State’s General Fund. Thus, the State would lose the entire 6% sales tax that is currently collected on sales of items in the new Urban Enterprise Zone. This would be a particularly burdensome loss to the State in regard to big-ticket items.

The Committee recommends that a review of the Urban Enterprise Zone Program and its effectiveness is necessary to determine the best course of action in relation to future modifications or expansions of the Urban Enterprise Zone Program in New Jersey. To date, there has not been a comprehensive review of the Urban Enterprise Zone program by an independent body. As a result, substantive data concerning the actual success of the Urban Enterprise Zone Program has not been provided to the Legislature.

RECOMMENDATION:

The Commission does not recommend enactment of this bill.

COMMISSION MEMBERS FOR PROPOSAL: 0

COMMISSION MEMBERS AGAINST PROPOSAL: 6

COMMISSION MEMBERS ABSTAINING: 0

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